Preliminary

Not for publication

STABLE FARM INCOME

A TENTATIVE PROPOSAL FOR ADJUSTING PRICE SUPPORT LEVELS TO MAINTAIN FARM INCOME WHILE SHIFTING PRODUCTION TO PEACETIME NEEDS

For Administrative Use Only

Washington, D. C.
January, 1945

FOREWORD

The exigencies of war have not only created new problems in agriculture, but have accentuated old ones. The problems of production adjustment, price supports, surplus disposal, and international trade, that have confronted us so forcefully in depression years, will be with us again after this conflict.

The Steagall Amendment to the National Stabilization Act is intended to protect farmers against collapses of markets for their products during reconversion. But what kind of reconversion does agriculture face? Must there be general surpluses of most farm products when peace returns?

The essentials of any sound agricultural adjustment program must be: (1) maintenance of adequate outlets for a high level of food production, and (2) establishment of price relationships between commodities that provide the incentives to shift production to a peacetime pattern of needs.

If demand is maintained at a high level, agricultural adjustments will require chiefly production shifts between commodities, not over-all restriction. The proposal outlined here not only provides for the unfreezing of wartime price relationships without sacrificing the basic income protection intended to be afforded agricultural producers by legislation; it also provides, as far as price policy is concerned, the basis for developing a sound national program for agriculture that will materially contribute to our regaining that flexibility and initiative of enterprise essential to a people whose progress depends upon their ability to conquer new markets.

The proposal outlined here was developed by Frederick V. Waugh and Herman Southworth and submitted on August 9, 1944, to the Office of Distribution of the War Food Administration in the form of an administrative memorandum entitled, "Proposal for the Adjustment of Support Prices." Since that date the proposal has been studied by the various Branches of the Office of Distribution. Although several Branches pointed out practical difficulties in applying the proposal to their commodities, there was agreement as to the soundness of the general approach. The suggestions of the Branches have been used freely in preparing this more comprehensive draft which is intended to serve as a basis for further discussion and clarification of the issues involved.

The report was prepared by Frederick V. Waugh, Herman Southworth, and Rudolph Patzig, in consultation with economists in the commodity Branches of WFA and in other agencies, including the Crop Reporting Board.

STABLE FARM INCOME

(A Tentative Proposal for Adjusting Price Support Levels to Maintain Farm Income while Shifting Production to Peacetime Needs)

Farm output has been increased 30 percent to meet war needs. When the war is over, the American farmer will face a big and difficult job of readjustment. Everyone recognizes that farmers deserve and must receive equal protection with other business groups during the reconversion period.

Present legislation provides that prices of most of the important farm products be supported at levels equal or comparable to the 1910-14 parity for a period of at least two years following the end of the war. If prices are supported at these levels for unlimited production, however, there are almost certain to be very serious difficulties. It is, therefore, proposed that a "base production" be established for each agricultural commodity and that producers be guaranteed income equal to base production times parity price. Farmers would be given complete freedom to grow as much or as little of each commodity as they pleased. There would be no acreage allotments, quotas, or individual farm goals.

The Impracticability of Parity Prices for Unlimited Production

To support the prices of unlimited production of all the principal agricultural products at 90 percent of 1910-14 parity probably would be very expensive. The Government would have to be prepared to buy whatever amounts the market would not absorb at the support levels. Large amounts of public funds would have to be expended yearly for the purchase of surpluses which the Government did not want and for which it had few, if any, outlets. Some of the surpluses might be distributed through programs like school lunches, some might be diverted to non-food uses, but probably large quantities would either go to waste or pile up in warehouses where they would be a continued threat to the markets in later years.

Even more serious than large expenditures of public funds, such a price-support policy would lead to continued unbalance in agricultural production. The 1910-14 parity prices no longer reflect fair and equitable relationships between different commodities. There have been important changes both in production techniques and consumption patterns as well as in marketing practices during the past thirty years. For example, 90 percent of parity is too high a support price for eggs and too low for milk. With a post-war national income of, say, 120 billion dollars, such a price support program would probably result in an annual production of 165 million cases of eggs. If prices are held at these levels domestic consumption may be expected to be only 135 million cases, leaving a surplus of 30 million cases which would have to be bought by the Government. On the other hand, a 90 percent of parity support price for milk after the war is likely to bring forth an output of about 116 billion pounds, whereas the market would take 123 billion pounds, indicating a deficit of 7 billion pounds.

Our price support policies should encourage a shift from egg production to milk production, not only because this will save money for the taxpayer, but because it is quite evident that agriculture eventually must adjust itself to the needs of the market. The public certainly will not permanently pay agriculture for producing the things that are not wanted, nor for not producing the things that are wanted and needed. Price supports should be designed to help bring about a balance between production and consumption and thus provide for the socially useful employment of our resources. Rigid adherence to parity will not help bring about such a balance. In fact, it will tend to prevent it.

Price Support Versus Direct Subsidies to Farmers

Some of these difficulties could be partly overcome if market prices were allowed to seek their own level and if farmers received supplementary payments to make up the differences between market prices and 90 percent of parity. Under such a program the Government would not have to buy and handle any of the surplus commodities. Large crops would move into consumption at low prices and the Government would make up the difference by direct subsidies to producers. Thus, there would be no waste of food, nor any piling up of unwanted stocks.

Such a policy would resolve only part of the difficulties, however. If the supplementary payments made up the full differences between market prices and 90 percent of parity, there still would be no incentive for farmers to readjust their operations to the peacetime needs of the market. Such payments, in effect, might even prevent production shifts which are needed. Returns to producers would still make the production of unwanted commodities profitable--and, in some cases, more profitable than the production of foods which are needed.

Neither producers nor the consuming public will long tolerate a program that encourages the production of surpluses which have to be diverted into wasteful uses or destroyed while, at the same time, unsatisfied demands cannot be met because of inadequate incentives to produce.

Another difficulty with direct subsidy payments to producers is that such a program would be administratively very complex; it would make it necessary for each farmer to keep detailed records in connection with all of his sales and would require a large number of Government agents to check the accuracy of such records as a basis for the subsidy payments.

The main question, however, is not whether market prices should be supported or whether farmers should receive subsidy payments in addition to the market price. The main question is to determine the proper level of prices and incomes. The plan proposed here could be carried out either through price supports or through supplementary payments made in addition to the market

price. In either case, it will be necessary to find some way of adjusting the level of prices or subsidies so that producers of some commodities get substantially more than 90 percent of parity while the producers of other commodities get substantially less.

Production Control

One way of dealing with excess production, of course, is by production control. If the market will absorb only 135 million cases of eggs at 90 percent of parity, the Government could try to prevent farmers from producing more than this amount. But this approach would require individual farm goals, allotments, and quotas, together with fairly elaborate machinery for checking the compliance of each farmer and for penalizing farmers who fail to stay within their assigned quotas. This method is likely to be neither popular nor successful. Efforts to reduce production in the past were largely unsuccessful, except, perhaps, in the case of cotton. If they are to be more effective in the future it will probably be necessary to employ more coercive methods.

A program to restrict output would mean departure from the present established policy of depending upon price to guide production. It would be a negative policy, when what is needed is a positive program of adjustment. The fundamental economic approach to the problem of adjusting our greatly expanded agricultural capacity to a peacetime pattern and volume of needs must be guided by a course of action that assures full use of our Nation's productive resources for the satisfaction of the needs of our people. If we all produce freely and exchange the products of our labor, there must result an ever-increasing richness of economic life. Balanced abundance rather than restricted production is our post-war economic perspective.

Above all, production restriction would maintain farm prices at the expense of farm income--an infraction of the real intent of the Steagall Amendment. Farmers want fair prices, but not at the expense of market outlets.

A modification to avoid the need of production control would be to make compensatory payments only on that part of production falling within assigned allotments. But this involves again the administrative complexity and regimentation of setting individual farm allotments on many different commodities.

The essentials of any sound agricultural adjustment program must be (1) maintenance of adequate outlets for a high level of food production, and (2) establishment of price relationships between commodities that provide the incentives to shift production to a peacetime pattern of needs.

Success in maintaining high levels of employment in all sections of the economy will go a long way toward sustaining our greatly expanded agricultural capacity. Social security programs, particularly programs to assure

all consumers at least a minimum adequate diet, will help to maintain food consumption at satisfactory levels. With a high level of demand assured, agricultural adjustment will require chiefly production shifts between commodities, not over-all contraction.

Certainly, our wartime experience has demonstrated that price supports can be a very powerful influence over production. If price supports can be properly adjusted in the future, they may be relied upon to be an important factor in the process of readjusting our agricultural production to peacetime needs. In an economy of balanced abundance, there will be no need to abridge the farmer's right to produce.

Base Production

The proposal outlined here calls for guaranteeing that the producers of any commodity will receive total income equal to base production times parity price. The first and most important step is to determine base production. The base for each commodity would be computed by the Department of Agriculture; it would include estimates of the amount the market would absorb at parity prices together with allowances for desirable changes in carry-over stocks, for probable exports, and for any food distribution programs authorized by Congress.

Stability of agricultural production and income can be a very important factor in maintaining employment throughout the whole economy. Therefore, in computing the amounts of agricultural commodities the market will take at parity prices, the Department should estimate the requirements under normal conditions of a fairly high level of industrial activity and reasonably full employment. In case there should be a recession in business and in consumer purchasing power, an expansion in food distribution programs will be called for. The proposed National Food Allotment Program, aiming at making adequate food available to low-income families, should prove an effective means of maintaining food consumption at desirable levels. Such a program should be kept flexible and the Department should have the funds and the administrative machinery necessary to double, triple, or quadruple program operations in periods of falling national income and increasing unemployment.

Support Prices

The proposal that is developed here provides for the essentials of a sound adjustment program--the unfreezing of price maladjustments inherent in a rigid application of the parity formula. The adjustments will be made in the following manner:

(1) In the fall of each year--at the time when production goals and support prices are now developed--parity prices for each farm product will be determined for the coming year. At the same time the base production will be computed for each crop--representing the amount the market would absorb at parity prices under normal conditions, with due allowance for desirable changes in carry-over stocks, exports, and domestic food distribution programs.

(2) This base production for each commodity multiplied by the parity price will be the income guaranteed to producers of the commodity.

(3) To make this income guarantee effective, a schedule of support prices will be worked out for each commodity, varying with production. The formula would be simply:

$$\text{Guaranteed price} = \text{Parity price} \times \frac{\text{Base production}}{\text{Actual production}}$$

For example, if egg production exceeds base production by 10 percent, prices will be supported at 90 percent of parity; on the other hand, if production falls 10 percent short of the base, the support price will be 110 percent of parity.

An expanded outlook program will provide farmers information for making their production plans. State and county meetings will be held at which farmers will be given full information about the support price schedules. Also they will be given the best available information on probable plantings, yield, and production, which will be interpreted to indicate what the actual price support level is likely to be.

The Government representatives at these meetings will make clear the following points:

(a) The actual level of price support (or of compensatory payments) will depend upon the volume of production.

(b) Farmers--individually or as groups--are entirely free to produce what they please and as much as they please. There is no reward of any kind for not producing.

(4) Before the start of the marketing season for each commodity production will be estimated. On the basis of this production the price actually to be supported (either through direct purchases or compensatory payments) will be determined from the guaranteed price schedule and a corresponding announcement made. This support price is the minimum return that the Government will guarantee

producers for a commodity during the marketing season. It is the price that will assure producers for each commodity an income at least equal to the value of base production at the parity price.

With most crops a yearly determination of the guaranteed income and the actual support prices in the main producing areas will be sufficient. In the case of products like milk and eggs that are produced the year around, the guaranteed income and the guaranteed price schedule might be announced on the basis of quarterly estimates of production.

Production Guidance

It is essential to this proposal that the base production not be held up to producers as a goal at which production would have to be restricted. Instead of saying to farmers, "You must not produce more than this amount," the Government will be saying, "This is the level of production on which the parity price will be guaranteed. If production conditions are such that you prefer to produce more than this quantity at a correspondingly lower price, you are free to do so. Whatever the quantity you produce, your income will be guaranteed to be no less than base production times parity price."

This still does not tell the individual farmer what price he will receive for each commodity. That will depend on how much other farmers produce. To determine intelligently the best production plan, each farmer, therefore, needs to be closely informed of aggregate production plans of all producers. Surveys will be made of production intentions and individual farmers will be in position to avail themselves of this information early enough to adjust their operations to the most advantageous pattern of employing their resources.

Production Adjustments

Such a program will provide positive encouragement to producers in making desirable production shifts. For commodities whose production costs have gone down, so that parity prices would encourage over-production, farmers will be enabled to choose, collectively, a level of output that is in line with demand and for which will be guaranteed a return that is in line with costs of production. Eggs would likely provide an example of this. That is, probably farmers would produce more than the base production for eggs--and the price support would be correspondingly reduced.

For commodities whose production costs have risen relative to other commodities, so that parity prices fail to bring forth an adequate output, farmers will be guaranteed prices above parity as an inducement to greater production. This would likely be the case with dairy production.

Likewise, commodities in relatively stronger demand than obtained in the 1910-14 base period will benefit from the setting of a relatively high base production and a correspondingly high price and income guarantee. For commodities in weaker demand, the determination of relatively lower base production will adjust the support price and parity income downward.

Thus, the shifts in production that producers choose will reflect actual production conditions. For any particular commodity, production in lower-cost areas will be encouraged. This is an economically sounder process of adjustment than pro rata allotments under a program of production control. Producers will have no incentive to continue inefficient lines of production merely to protect their acreage base. They will be free to shift to more profitable alternatives, and relative profitability of production as between commodities may be depended upon to reflect actual supply and demand conditions.

Under this proposal the incentives to produce will be towards the most efficient pattern of output and towards the balancing of production and consumption. At the same time, aggregate producer income will be protected.

Crop Insurance

It has long been recognized that price supports on the basis of rigid guarantees that take no account of yields are inequitable. In years of low yields, not to mention crop failure, they do not represent income guarantees to farmers. In years of bumper crops, on the other hand, they provide a windfall that is hard to justify. In recent years weather conditions, on the whole, have been unusually favorable, largely accounting for the generally high level of yields. Such yields can hardly be expected to continue.

A feature of the proposal is that for any commodity the actual support price, since it depends on actual production, will vary inversely with yield. It will be high when yield is low, low when yield is high. The income guaranteed producers of a commodity will be the same, however, regardless of yield. Thus, an over-all crop insurance is automatically provided for. Although the proposed program will not take the place of crop insurance available to individual producers, it will even out the fluctuations in farm income that result from variations in national average yields.

Administrative Aspects

Administration of this proposal will unquestionably offer a number of problems. However, they are not essentially different from those that are faced under other programs. Most of them seem easier to cope with than the administrative complexity of a thorough-going production control program imposed upon individual producers. Certainly the problems offer less difficulties

than attempts to buy all the surpluses likely to be produced at rigid prices and to find useful outlets for the foods thus acquired.

Obvious problems center around forecasting demand in determining base production, and around forecasting production as a basis for announcing the actual price that will be supported. The Department of Agriculture, however, has for a number of years been forecasting demand as a basis for outlook work, and during the war as a basis for requirement estimates. It also has a highly systematized procedure for making production forecasts. Some further development or supplementation of work in both these lines might be required. But the difficulties should hardly prove insuperable.

Summary of Advantages

The basic protection to agriculture during the reconversion period must include maintenance of profitable outlets for a high level of production, preferably as part of a national program for stable, high-level employment and the maintenance of high living standards, including adequate nutrition. Within such a program, agricultural adjustment will require chiefly production shifts between different commodities, not over-all contraction. Expanding outlets for some products will provide alternate opportunities to farmers now producing the commodities that will be less needed in a peacetime pattern of needs.

The proposal here set forth is designed precisely to bring about such needed shifts without sacrificing the basic protection which agriculture has been given by law against losses on expanded wartime production. The proposal, unfreezing the wartime price relationships, encourages increased production of the commodities most needed to meet peacetime demand, at the expense of production of commodities that would be produced in surplus at parity prices.

The proposal provides a positive basis for desirable production adjustments, while, at the same time, insuring producers of individual commodities equitable price relationships and an income commensurate with the present-day cost of producing needed foods. Instead of enforcing an arbitrary production pattern in order to maintain a badly adjusted price structure, the proposal substitutes freedom of farmers to plan their own production, guided by sound price relationships.

Thus, farmers will be provided an opportunity for efficiency they do not possess under a program of price rigidities and production restriction, which prevents the exchange of the products of their labor against the product of other groups in our economy from being equal to their contribution to the total wealth of the Nation.

Modification of legislation to the effect of guaranteeing producers stability of income instead of fixed prices, regardless of quantities produced, would, in summary, benefit:

(1) Farmers, by removing obstacles to production shifts that eventually are unavoidable.

(2) The public, by making agricultural production more responsive to the actual needs of consumers, by passing on the benefits from increased production efficiencies, and by preventing the diversion of socially valuable resources to the production of goods that cannot be consumed.

(3) The Government, by relieving it of an obligation which would be administratively difficult to meet and the fulfillment of which might defeat the very purpose for which it was designed.

The first essential of any sound post-war agricultural adjustment program must be maintenance of adequate outlets for a high level of production; the second essential is to unfreeze price relationships that are out of line, so that the wartime pattern of production can adjust itself to peacetime market outlets. The chief remaining need would be for aid to particular producer groups on whom the shifts called for in production impose special hardships. The restoration of flourishing world trade will be important for export commodities for which neither a high level of employment nor price supports will be adequate by themselves to bring about a really satisfactory solution.

* * * * * * * * *